BEFORE

THE PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 2019-232-A

IN RE:	
Procedure to Address Conceptual Issues Around Non-Allowable Expenses (See Page Number 4 of Order No. 2019-341)	**JOINT RESPONSE OF DUKE ENERGY CAROLINAS, LLC AND DUKE ENERGY PROGRESS, LLC**

Duke Energy Carolinas, LLC ("DEC") and Duke Energy Progress, LLC ("DEP") (collectively, "Duke Energy" or the "Companies") file this joint response to comments filed by the Office of Regulatory Staff ("ORS") and Dominion Energy South Carolina ("DESC") in the above-referenced proceeding, which addresses issues relating to non-allowable expenses.

I. Agreement With ORS

The Companies appreciate the Commission's willingness to provide the parties to this docket additional time for continued negotiations and productive conversations about non-allowable expenses. To that end, the Companies have reached some consensus with ORS regarding certain expenses that are appropriately considered non-allowable and not recoverable from customers. Notwithstanding the comments below, which highlight areas of disagreement with ORS, the Companies and ORS generally agree that the items identified in Exhibit A to this Joint Response are non-allowable.[1] These items include, for example, goodwill and brand/image

[1] Notwithstanding the Companies' support for the comments filed by DESC in this docket, this agreement is only applicable to DEC and DEP.

advertising, advertising for non-regulated products and services, and alcohol. The Companies are implementing accounting measures to separate any such expenses from utility rate requests.

II. Response

Preliminarily, the Companies generally agree with ORS's comments that, in order to be eligible for cost recovery, a utility's costs should be connected to the provision of utility service. The Companies further believe that prudently incurred costs associated with utility service should be recoverable. Whether and to what extent there is a connection to utility service and whether and to what extent the costs were prudently incurred must be evaluated on a case-by-case basis to determine whether cost recovery is appropriate in a particular context. Indeed, such questions can be extremely fact-specific and cannot be made on a universal basis in a generic proceeding or even in a rulemaking. Ultimately, the Companies submit that any guidance issued by the Commission in this proceeding should preserve utilities' ability to exercise discretion and make decisions that best support utility operations in serving customers and the communities in utility service territories. Importantly, it is up to the Companies to exercise management discretion to manage employees, infrastructure, operations and finance in serving customers, and while the Commission evaluates whether costs are associated with utility service and are prudently incurred and whether rates are just and reasonable, the Commission should not step into the shoes of the management of the Companies. *See, e.g.*, Order No. 2005-42 at 31, Docket No. 2005-212-S (Feb. 2, 2005) (While this Commission's decisions are often based on the prudence or imprudence of management decisions . . . this Commission has no authority to manage the utility.").[2] Accordingly, the amount

[2] *See also* Order No. 2019-323 at 56, Docket No. 2018-319-E (May 21, 2019) ("[H]ow the Company decided to compensate its employees is a managerial decision, which is the sole responsibility of the Company. How to pay employees is a managerial decision, and as long as the costs and results are reasonable this Commission has no basis to reject the compensation at issue.").

of costs, whether those costs are connected to the utility's overall business in serving customers, and whether those costs are prudently incurred are all fact determinations to be decided by the Commission in utility proceedings, consistent with settled law in this State. *See Utils. Servs. of S.C., Inc. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 106, 708 S.E.2d 755, 761 (2011) ("[W]e hold the PSC is the ultimate fact-finder in a ratemaking application. It has the power to independently determine whether an applicant has met its burden of proof.").

1. Guidance concerning non-allowables is consistent with the law, and an appropriate vehicle to address concerns raised in this docket, while regulations to categorically deny expenses before they are even heard are not appropriate.

As discussed in the Companies' comments filed in this docket on September 6, 2019, promulgation of a regulation that categorically excludes certain expenses, as suggested by ORS, would contravene established S.C. Supreme Court precedent, which requires that a utility be granted a presumption that its expenses are reasonable and were incurred in good faith. *See Hamm v. S.C. Pub. Serv. Comm'n*, 309 S.C. 282, 286, 422 S.E.2d 110, 112 (1992) (internal citations omitted) ("*Hamm*"). This presumption "shifts the burden of production on to the Commission or other contesting party to demonstrate a tenable basis for raising the specter of imprudence." *Id.* The promulgation of a regulation that circumvents this presumption that the utility's incurred costs were "reasonable and were incurred in good faith" would be improper, particularly where there is material risk that the regulation would be over-inclusive and erroneously exclude costs for which recovery is appropriate.

In *Hamm*, the S.C. Supreme Court articulated three principles that must be adhered to by the Commission: (1) the declaration of an existing practice may not be substituted for an evaluation of the evidence; (2) a previously adopted policy may not furnish the sole basis for the Commission's action; and (3) the Commission must set forth findings that are sufficiently detailed

to enable the reviewing court to determine whether the findings are supported by the evidence and whether the law has been properly applied to those findings. *Hamm*, 309 S.C. at 288-89, 422 S.E.2d at 114. A regulation that displaces the Commission's responsibility to evaluate evidence and set forth its findings in a sufficiently detailed way as to permit evaluation by the reviewing court would fundamentally contravene these three governing principles. Further, S.C. Supreme Court precedent requires that utilities be afforded an opportunity to provide evidence in response to a party's challenge to the utility's expenses. *Utils. Servs.*, 392 S.C. at 109-10, 708 S.E.2d at 762-63. If a regulation categorically disallowed an expense, the utility would not be provided an opportunity to proffer such evidence, which would negate due process and raise takings issues.

The Companies also have reservations about a regulation that displaces the role of the Commission as the fact-finder in proceedings before it. As referenced in DESC's comments and explained by the S.C. Supreme Court:

> [W]e hold the PSC is the ultimate fact-finder in a ratemaking application. It has the power to independently determine whether an applicant has met its burden of proof. The PSC is not bound by ORS's determination that an expenditure was reasonable and proper for inclusion in a rate application. The PSC may determine—independent of any party—that an expenditure is suspect and requires further scrutiny. To accept the contention that the PSC is bound by the recommendations of ORS would place ORS in the same untenable dual investigative—adjudicative role that challenged the PSC prior to the 2004 amendments.

Id. at 106, 708 S.E.2d at 761. As appealing as it may be for certain parties, the Commission cannot cede its role as "the ultimate fact-finder" or surrender its responsibility to independently evaluate rate applications by adopting regulations that preclude or limit the presentation of evidence. As DESC points out, adopting regulations that limit a utility's ability to present evidence supporting its expenses would violate substantive and procedural due process. *See* S.C. Const. art. I, § 22; *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308 (1989); *accord S. Bell Telephone & Telegraph*

Co. v. Pub. Serv. Comm'n of S.C., 270 S.C. 590, 595-96, 244 S.E.2d 278, 281 (1978) ("*Southern Bell*").

As described above, the Companies endorse DESC's comments that a determination by the Commission on whether a specific expense is allowable, at a specific time, incurred by a specific utility, should be made in rate cases. The Companies do not believe it is within legal bounds of the precedent cited in these comments to mandate expenses as allowable or not allowable in a generic docket.

Even with such guardrails, the Commission can issue general policy guidance to provide additional information to parties and the ORS as to what the Commission would find useful in making the kind of fact determinations articulated by the Court. Such guidelines could retain the Commission's flexibility and ability to evaluate all the facts and circumstances relevant in a particular case. Such policy guidance could take the form of a Commission order, issued in this proceeding. As ORS points out, the key distinction between policy guidance and a regulation is whether the Commission retains discretion to follow or not to follow its stated policy in individual cases. *See Joseph v. S.C. Dep't of Labor, Licensing & Regulation*, 417 S.C. 436, 454, 790 S.E.2d 763, 772 (2016). The goals articulated by ORS—clarity and streamlined investigation, audit, and examination processes—would also be achieved through the issuance of guidelines. Moreover, guidelines would have the added benefit of preserving Commission discretion and flexibility, which better serves customers.[3] The Companies provide examples of potential guidance that may aid all parties facing these issues:

[3] As one example, if settlements were to be categorically non-recoverable, as suggested in Attachment A to ORS's comments filed on September 6, 2019, the Commission would not have had the discretion to permit DEP to recover costs associated with its defense of the CertainTEED litigation. Instead, in that case, the Commission concluded that "[t]he resulting more than $50 million in savings to customers demonstrates to us that the decision to enter into litigation and

Examples of Potential Commission Guidelines for Consideration

1. Parties arguing for a disallowance of an expense should endeavor to fully articulate their reasoning in their direct testimony, providing all information necessary for the Commission to consider whether the presumption of reasonableness has been rebutted. Expenses argued for disallowance would ideally be articulated with clarity and specificity, and not summarily addressed. Parties seeking disallowance should, insofar as it is practicable,[4] attach discovery responses which support their position to their prefiled testimony, as well as any other information which meets reasonable evidentiary standard.[5]

2. Parties defending against disallowances should, insofar as practicable, address such disallowances in prefiled testimony to provide the Commission with a framing of the issues prior to the start of an evidentiary hearing. Upon identification of a proposed disallowance, the utility should endeavor to gather facts, materials, documents to support recoverability, if recoverability is still sought, and attach those to prefiled rebuttal testimony. Utility policies may also be helpful for the Commission to consider whether the utility's policies safeguard against unwarranted and excessive expenses in any given category.

3. The Commission urges parties to identify such items early on, and particularly with non-material expenses, the Commission encourages parties to explore settlements if possible to aid in focusing the evidentiary hearing on material issues impacting rates.

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settlement with CertainTEED was strategic, reasonable, and prudent," and caused the Commission to conclude that the associated litigation costs were recoverable. Ultimately, the evaluation of the prudency of a utility's decision-making cannot be blindly categorized. While the Companies understand the appeal of convenience offered by a hard-and-fast rule, for most of the categories remaining in dispute, the Commission, customers, and the utilities are better served by fact specific determinations in rate cases.

[4] *See* S.C. Code Ann. Regs. 103-845(C) ("All parties of record, insofar as it is practicable, should prefile with all other parties of record copies of prepared testimony and exhibits which the party of record proposes to use during a hearing.").

[5] S.C. Supreme Court precedent places a burden of evidentiary production on parties who challenge utilities' presumption of reasonableness. *Hamm*, 309 S.C. at 286, 422 S.E.2d at 112. In practice before the Commission, evidence in the form of testimony and exhibits is pre-filed.

III. Expense Recording

ORS asks the Commission to instruct utilities to "categorize and record any incurred expenses considered as non-allowable for rate making purposes as 'non-operating' or 'below-the-line.'" ORS Comments at 3. If the Companies only operated in South Carolina, and only had South Carolina accounting rules to consider, that might be possible. However, because the Companies operate in multiple jurisdictions, and costs are shared over several states in the Duke enterprise, and between state and federal ratemaking jurisdictions, it is not possible to institute SC-only accounting policies. Instead, generally speaking, the Companies would need to record expenses in the normal course and instead implement policies and charging guidance to be able to identify the expense in order to remove it from South Carolina rate proceedings. Further, the Companies follow the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts and must make decisions about above and below the line based on FERC guidance. For these reasons, the Companies propose that any guidance from the Commission be directed at the result desired for non-allowable expenses, and the utility should be allowed to have its own practices for best achieving that result.

IV. Expense Categories

The Companies provide the following responses to the categories of non-allowable expenses originally contained in Attachment A to ORS's comments filed on September 6, 2019 (the "ORS Table"). The Companies have annotated the ORS Table and attached it as Exhibit B to this Joint Response. It is important to note that several items that ORS portrays as non-allowable in the ORS Table have been, in fact, allowable. The Companies' edits to the ORS Table include case citations that illustrate this point, and they are further discussed below.

1. Imprudent or Excessive Expenses

In looking at the ORS Table in Exhibit B, the first category is labeled "Imprudent or Excessive Expenses." Of course, the Companies agree that, in general, imprudent or excessive expenses should not be recovered from customers. However, "imprudence" and "excessiveness" are inherently subjective criteria and must be evaluated on a case-by-case basis. As discussed above, S.C. Supreme Court precedent is clear that a utility's expenses are presumed to be reasonable and incurred in good faith, and a contesting party bears the burden of demonstrating why such expenses would be imprudent and inappropriate for cost recovery. *Hamm*, 309 S.C. at 286, 422 S.E.2d at 112. Of course, the presumption of reasonableness is not dispositive, and where a party challenges the utility's expenditures, the utility has an opportunity to respond if it wants the contested costs considered for ratemaking purposes. *Utils. Servs.*, 392 S.C. at 109-10, 708 S.E.2d at 762-63. The Companies and ORS agree that whether an expense is "imprudent" or "excessive" requires a fact determination within a rate case.

2. Lobbying and Political Advertising

The next category on the ORS Table in Exhibit B is labeled "Lobbying and Political Advertising." As noted in Exhibit A, the Companies agree with ORS that lobbying expenses, including donations, monetary contributions, and trade association dues attributable to lobbying are non-allowable expenses. However, there are other items in the description in the ORS Table that the Companies believe are fact specific, subjective, and would require a determination based upon evidence and argument in a rate case. For example, trade association dues not associated with lobbying should not be disallowed just because the trade association engages in lobbying at times. Customer and stakeholder educational materials and efforts should also be allowable – costs incurred in trying to reach consensus with stakeholders and to inform customers should be

allowable, or at subject to a fact determination as outlined in the S.C. Supreme Court precedent on ratemaking.

3. Political, Charitable, Social, and Community Contributions

The next category in the ORS Table in Exhibit B is "Political, Charitable, Social and Community Contributions." While the Companies agree with ORS that, in general, monetary contributions and sponsorships not reasonably associated with the utility should not be allowed for ratemaking, the Companies believe that reasonable sponsorships and corporate support of community activity in Duke-served areas are an important and necessary business and utility activity. The Companies believe it is important to actively participate in the communities they serve. For example, there is a wide gap between a political monetary contribution (non-allowable) and a sponsorship of a table at a community function designed to engage and better the business community in which Duke utilities have a unique and key role, which the Companies believe is an allowable expense. Such activities include supporting and participating in events hosted by chambers of commerce, economic development associations, and tourism organizations, which all exist to bring more industry and residents to the state and serve as local community vehicles. Chambers of Commerce, which utilities may support, also make important contributions to their respective communities. The Companies pay dues to be a part of these organizations because the Companies believe it is important to participate in the communities they serve and to be engaged at a local level to ensure they understand the needs of customers, especially as initiatives, storm response, and infrastructure improvements occur. It is natural that the Companies' reasonable support of the activities of such organizations is part of their corporate and utility responsibility to be present and engaged in the communities they serve, and is a reasonable corporate function.

4. Institutional Advertising

The next category on the ORS table in Exhibit B is "Institutional Advertising." As shown in Exhibit A, the Companies generally agree with ORS that goodwill and brand/image advertising and advertising for non-regulated products and services should be excluded from ratemaking. However, the Companies could find no support in the orders cited by ORS for the proposition that expenses related to "advertising to promote increased consumption of utility service" should be disallowed—this goes against potential future rate designs to shift load to less expensive times, or reasonable rate design that may seek to increase consumption in non-peak times versus peak times. Further, as noted in DESC's most recent filing in this docket, this position contradicts guidance in the FERC Uniform System of Accounts guidance, which provides as follows: "This account shall include the cost of labor, materials used and expenses incurred in advertising designed to promote or retain the use of utility service, except advertising the sale of merchandise by the utility." 18 C.F.R. Pt. 101, FERC Uniform System of Accounts, 913 Advertising Expenses (Major Only). This means that a categoric approach to all amounts recorded in this accounting classification is problematic, as accounting in this category is also used in advertising to promote the utilization of certain tariffs, such as those that enable energy efficiency programs or net metering, which are beneficial to customers and supported by SC law. Expenses in this category other than those identified in Exhibit A should be reserved, if contested, for fact finding and determination by the Commission.

5. Recreation, Entertainment or Non-Essential Employee Benefits

The next category on the ORS Table is labeled "Recreation, Entertainment or Non-Essential Employee Benefits." As shown in Exhibit A, the Companies agree that the following categories of cost are not appropriate for cost recovery in SC: spousal travel, religious clubs,

country club dues, non-professional social or religious organizations, and alcohol. However, many other items included in the ORS Table in Exhibit B, as annotated by the Companies, should be subject to a fact determination in rate cases as articulated by the S.C. Supreme Court in *Hamm*. As DESC pointed out in its initial comments filed in this proceeding, "[o]rganizations of the size and scope of a utility need organized processes and programs for acknowledging and rewarding accomplishments." DESC Comments at 4. Employees who are engaged and motivated are more productive and better equipped to deliver high quality and safe service to customers. There are many types of expenses that have routinely been contested and litigated in this category, and the Companies believe that is the appropriate forum for such consideration. A key item for consideration is whether the Companies' policies safeguard against unwarranted and excessive expenses in this category.

i. Employee Events

The Companies disagree that "employee parties and events" and "employee competitions for professional recognition" should be categorically excluded from recovery. Employee events and competitions can serve many purposes that benefit customers, including to recruit, train, motivate, and retain qualified employees. For example, the Companies consider occasional team lunches a necessary part of creating and fostering a supportive corporate work environment and in many cases having important conversation essential to team building and achieving efficiencies. Whether or not a lunch or event is excessive or unreasonable under the circumstances is a fact-specific determination, and the categoric disallowance of normal and reasonable company employee expenses should not be disallowed just because they fall in this accounting category. Another example is the lineman's rodeo, the costs for which the Commission permitted recovery

in the most recent DEC and DEP rate cases.[6] The lineman's rodeo is an event that drives a culture of teamwork, helps linemen refine their skills through training and competition, and showcases their skills as a recruiting tool in collaboration with local colleges and lineman schools at a time when utilities struggle to recruit new workers to these jobs. Linemen participate in these rodeo competitions to continually refine their skills, which in turn directly benefits customers with faster, safer, more reliable service. With an aging workforce, this event also serves as an important component of building a talent pipeline for the Companies' future workforce needs. This is a good example of the type of "employee event" is directly related to the Companies' provision of high quality, reliable service and should not be excluded from recovery.

ii. Employee Incentive and Service Awards

The Companies also take issue with the categorical exclusion of "employee incentive and service awards" as suggested by the ORS Table in Exhibit B. Non-excessive, reasonable incentives and awards that are in line with common business practices and that are implemented with the intent of motivating and retaining qualified employees are appropriate for recovery. The Commission recently addressed this issue and concluded:

> As the incentive plans result in market-competitive compensation that results in solid operations, there is no evidence that they are not working or that they disadvantage customers. No party has alleged that the "rank and file" employees are overpaid, and how the Company decided to compensate its employees is a managerial decision, which is the sole responsibility of the Company. How to pay employees is a managerial decision, and as long as the costs and results are reasonable this Commission has no basis to reject the compensation at issue. As such, there is no factual or evidentiary basis for the disallowance recommendation made by ORS.

[6] Order No. 2019-341 at 106, Docket No. 2018-318-E (May 21, 2019); Order No. 2019-323 at 30, Docket No. 2018-319-E (May 21, 2019).

Order No. 2019-323 at 56, Docket No. 2018-319-E (May 21, 2019).[7] The Commission reasoned that "[i]ncentive compensation, particularly that of non-executive level employees, is merely a portion of overall employee compensation expense and a prudently incurred cost of service." *Id.* at 56-57. The Commission should not, and the Companies believe cannot under the law, implement a policy that categorically disallows employee incentives. In fact, in addressing the recoverability of incentive compensation, the Commission has previously concluded, based on the testimony presented, that "incentive compensation is an accepted and necessary component of a utility company's compensation package" and "there are sound reasons for offering incentive compensation as part of a competitively reasonable compensation package." Order No. 2012-951 at 28, Docket No. 2012-218-E (Dec. 20, 2012).

The same reasoning applies equally to safety awards, spot bonuses, lump sum merit payments, and service awards. These are common tools used to manage large and diverse workforces and retain employees, particularly during periods of historically low unemployment. Employee turnover is costly, and the Companies agree with the points made by DESC in comments filed in this proceeding:

> In the utility industry and in businesses generally, firms invest in programs that recognize employees for extraordinary commitment to safety and customer service, for longevity in service, for major accomplishments in achieving corporate goals and for living out corporate values. They do so because this investment has a positive effect on the retention of skilled employees and the strengthening of a safety and customer service culture and general morale. That positive effect goes far beyond the cost of the events and awards provided.

[7] *See also* Order No. 2005-42 at 31, Docket No. 2005-212-S (Feb. 2, 2005) (While this Commission's decisions are often based on the prudence or imprudence of management decisions . . . this Commission has no authority to manage the utility.").

DESC Comments at 4. The Companies submit that, consistent with Commission precedent, so long as the overall level of employee compensation is reasonable and non-excessive, and as long as such results in safe, reliable, and customer-centered service, the manner in which the utility chooses to pay that compensation should have no bearing on the recoverability of such compensation.

iii. Employee Relocation and Recruitment

While ORS references the disallowance of "mortgage expense for employee relocation," the Companies would clarify that the Commission has previously disallowed employee mortgage interest expense,[8] but that such expenses would not include relocation expenses, which the Commission has previously permitted.[9] Regardless, employee recruitment packages, which can include the payment of relocation expenses, must allow the Companies to be market-competitive and permit the utility to attract employees who are skilled to provide safe, reliable, and customer-centered service. Moreover, whether a relocation or recruitment package is reasonable depends, in part, on the labor market and hiring environment. With an aging and increasingly mobile workforce, retention is a significant issue, and relocation and recruitment packages, along with market-competitive compensation, allow the Companies to recruit and retain skilled employees who possess the invaluable institutional knowledge necessary to provide safe, reliable, and efficient service to customers. Whether or not a specific relocation expense is reasonable depends

[8] Order No. 1991-595 at 24, Docket No. 1990-626-C (Aug. 20, 1991) (disallowing the recovery of employee mortgage interest expense paid for by utility).

[9] Order No. 1991-362 at 32, Docket No. 1989-229-C (May 28, 1991) (permitting recovery of employee moving expenses based on a four-year average); Order No. 1993-465 at 25, Docket No. 1992-619-E (June 7, 1993) (permitting the recovery of employee moving and relocation expenses based on a five-year average); Order No. 91-1140 at 8-9, Docket No. 1991-216-E (Dec. 18, 1991) (concluding that moving expenses were known and measurable and appropriate for ratemaking purposes).

upon (including but not limited to) the need for the employee, whether the employee has skills and knowledge useful to operations and efficiency, and the overall employment development efforts of the Companies. Those are all fact-finding determinations and would be case specific.

iv. Employee Travel

In the ORS Table, ORS also proposes to exclude "travel expenses including valet, concierge service and airfare upgrades." The Companies believe that ORS intended to propose the exclusion of "valet, concierge service and airfare upgrades" specifically and not travel expenses generally. These expenses should not be categorically disallowed and should instead be examined based on the facts and circumstances of a particular case, as much as changed with travel in the last decade. As one example, where a hotel doesn't offer self-parking, or where valet parking and self-parking cost the same amount, or where safety issues may be present from remote parking, valet parking should not be categorically excluded from recovery. Flight upgrades should also be considered for recovery when the total travel cost is reduced or equivalent because the employee may not have to pay to check a bag or may have other reasons for requiring advance boarding. The Companies also take this opportunity to reiterate that business-related travel expenses in general are otherwise appropriately recoverable. For example, the Commission has permitted the recovery of travel expenses to and from Commission hearings[10] and meals necessary during travel.[11] The Companies believe that, because business-related travel is conducted towards the end goal of the provision of utility service, non-excessive expenses associated with such travel are appropriately recovered through rates. A key item for consideration is whether the Companies'

[10] Order No. 2001-887 at 30, 33, Docket No. 2000-207-WS (Aug. 27, 2001) (permitting the recovery of costs associated with the hearing).

[11] Order No. 1991-595 at 24, Docket No. 1990-626-C (Aug. 20, 1991) (permitting the recovery of costs associated with "meals related to travel and overtime").

policies safeguard against unwarranted and excessive travel expenses. Again, whether such expenses are reasonable turn upon fact determinations best set in a rate case.

v. Employee Refreshments

ORS also references a categorical exclusion of employee refreshments. As the Commission has previously found, grocery items, including coffee, "are not unusual or extravagant and can be considered a necessary part of a decent working environment. . . . These expenses, in the Commission's opinion are properly included in allowable expenses." Order No. 1990-694, Docket No. 1989-610-WS (Aug. 1, 1990). The Companies agree with the Commission. Items such as employee refreshments enhance and reinforce employee engagement, and business units with more engaged employees have lower levels of turnover and absenteeism and higher levels of productivity and customer satisfaction. Likewise, when conducting training, planning, or other business meetings, as DESC points out in its initial comments filed in this proceeding, "it is more efficient for the Company to provide lunch for participants rather than adjourning the meeting while participants travel to a restaurant, eat and return. . . . [T]he value of the meal is more than offset by the value of the time that would otherwise be lost." DESC Comments at 5. When determining whether those meeting-related expenses are recoverable, the appropriate inquiry is whether the cost is excessive or unreasonable, not simply whether the cost exists. For these reasons, the Companies believe that as long as the associated expenses are non-excessive, employee refreshments are appropriately recoverable through rates.

vi. Organizational Memberships

The Companies believe that the exclusion of memberships to "social, recreational, fraternal or religious clubs" and "membership and association dues for non-professional social, fraternal, religious, civic and leadership organizations and promotional items" referenced by ORS should

not bar the recoverability of all organization memberships. For example, memberships in economic development and community organizations for certain employees—such as community relations and economic development managers—should be considered professional or business-related dues. These memberships enable utility employees to do their jobs more effectively to the ends of serving customers more effectively.

Membership in the various Chambers of Commerce and other civic organizations is an integral part of managing the Companies' business responsibly on behalf of customers and keeping in contact with a very important segment of customers. As a corporation, it is reasonable that Duke Energy belong to such organizations. Funds paid to these organizations are separately tracked and invoiced as being either (1) a donation or lobbying expense, which are not allowable, or (2) expenses in support of business, economic development, and the communities the Companies serve, which are allowable.

The Commission has recently reaffirmed its policy that dues paid to Chambers of Commerce are allowed on a 50 percent basis.[12] In prior orders, the Commission has found that such dues are appropriate for partial recovery because a utility's participation in Chambers of Commerce "is of value and benefit to the community as Chambers of Commerce provide access to services for small businesses which they would not have otherwise. Moreover, Chambers of Commerce improve community images." Order No. 1994-1229 at 26, Docket No. 1993-503-C (Dec. 5, 1994). The Commission has also found that "the Chamber of Commerce is an organization that is useful for recruiting industry into South Carolina, which ultimately inures to

[12] Order No. 2019-341 at 81, Docket No. 2018-318-E (May 21, 2019) ("We . . . have long-recognized that Chamber of Commerce dues are 50% allowed.") (citing Order No. 1994-1229 at 26, Docket No. 1993-503-C (Dec. 5, 1994); Order No. 1996-15 at 30-31, Docket No. 1995-1000-E (Jan. 9, 1996); Order No. 2001-887 at 36, Docket No. 2000-207-WS (Aug. 27, 2001); Order No. 2002-285 at 11, Docket No. 2001-164-WS (Apr. 18, 2002)).

the benefit of the ratepayers of South Carolina." Order No. 1996-15 at 31, Docket No. 1995-1000-E (Jan. 9, 1996). For these reasons, the Companies believe that such dues are not mere "community contributions," and should be recoverable.

Finally, the Companies disagree with the categorical exclusion of "non-essential employee training." Whether training is considered "non-essential" or "essential" is inherently subjective and a matter of perspective. However, disallowing any training that is not strictly essential is equivalent to the position that utilities' employees should only have a minimally adequate level of training. The Companies do not believe that their employees—as the operators of a complex and coordinated system of generation, transmission, and distribution assets that serve over 4 million customers—should have the bare minimum amount of training. In order to ensure safe and reliable service to customers, utility employees must have something more than minimally adequate training, and the cost of such training should be recoverable because it directly serves customers.

6. Development Grants and Sponsorships

The Companies would seek to clarify the categorization of development grants and sponsorships as non-allowable expenses. In this category, ORS uses a catch-all description: "Includes, but is not limited to, meals, meetings, donations, grants, dues, memberships, contributions and sponsorships for regional development alliances, economic development partnerships, homebuilders and realtors." It therefore could be construed that ORS's position is that all economic development costs should be non-recoverable. The Companies would first note that FERC Uniform System of Accounts, which the Companies adhere to, provides for booking economic development expenses above the line in account 912. More importantly, the Commission has taken a favorable view of efforts by utilities to enhance and augment economic

development in the State of South Carolina. For example, in approving economic development riders offered by DEP's predecessor Progress Energy Carolinas, the Commission found as follows:

> [T]he Riders have been instrumental in encouraging industrial expansion and job growth. We also agree that continuing the availability of these Riders is consistent with State economic development policy, and enhances capacity utilization and expedites high load factor growth within the PEC service area, Further, we concur that the Riders foster expanded tax base within the Company's service area in South Carolina.

Order No. 2006-775 at 2-3, Docket No. 1995-1078-E (Dec. 19, 2006). In another set of proceedings, the Commission approved certain contracts for electric service between South Carolina Electric & Gas Company ("SCE&G") and Michelin, Boeing, BOMAG, and Ritedose, but included the caveat that "[a]ny lost revenues resulting from each Contract cannot be collected from other customers."[13] Following a petition for rehearing from SCE&G and a letter of support for the petition from ORS, the Commission reconsidered its position and rescinded that provision, finding that "[t]his Commission has long supported economic development on the part of our utilities as being in accord with State economic development policy, and past approvals of such contracts and tariffs have been routinely granted."[14]

The Companies are consistently engaged in economic development activities for the benefit of their customers and the State. Through its participation in economic development organizations, including Chambers of Commerce, Duke is able to get to the table early for economic development opportunities, which benefits customers and the State of South Carolina at large. Duke's early involvement helps facilitate capacity and reliability discussions, method-of-

[13] Order No. 2015-554 at 1, Docket No. 2011-265-E (July 29, 2015); Order No. 2015-555 at 1, Docket No. 2011-203-E (July 29, 2019); Order No. 2015-556 at 1, Docket No. 2015-251-E (July 29, 2019); Order No. 2015-557 at 1, Docket No. 2015-252-E (July 29, 2015).

[14] Order No. 2015-588 at 1, Docket No. 2011-265-E (Aug. 12, 2015); Order No. 2015-587 at 1, Docket No. 2011-203-E (Aug. 12, 2019); Order No. 2015-589 at 1, Docket No. 2015-251-E (Aug. 12, 2019); Order No. 2015-590 at 1, Docket No. 2015-252-E (Aug. 12, 2015).

service decisions, and incentive considerations, which are important aspects of recruiting prospects, securing deals, and announcing wins for the state. Duke's contributions to these organizations have a direct link to winning projects for the State of South Carolina, including the Schaeffler Group USA expansion and Nestle Bottled Water in Chesterfield County, the Invista expansion in Kershaw County, and the Continental Tire expansion in Sumter County. The attraction of BMW to South Carolina is one dramatic example:

> BMW has invested more than $10 billion in South Carolina, employs approximately 11,000 people in the upstate. For 25 years, BMW's presence has driven the dramatic growth of the automotive sector. Four hundred automotive-related businesses, 40 tier-one suppliers operating in South Carolina. The BMW of North America supply network has grown from 22 companies in 1992 to more than 300 companies today. Close to zero automotive workers in 1992, and there are 72,000 people working in the automobile industry in South Carolina today.
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> When BMW established its South Carolina facility, they had special needs for startup and ongoing electricity. South Carolina was able to be flexible in working with them. BMW is a proven case study of how one company saying yes can be so impactful and transformative.[15]

As discussed at the referenced allowable ex parte briefing, energy prices and utilities' ability to be nimble and flexible in their service offerings can have a substantial impact on a company's decision whether or not to locate and grow in South Carolina. Recognizing that dynamic, and the important role businesses and industry can have in the quality of life of the citizens of this state, the Commission has long-supported economic development as a vital and appropriate component of utility strategy in this state, and the Companies therefore believe that expenses for associated efforts should be recoverable.

[15] Transcript of Allowable Ex Parte Briefing at 9-10, The Honorable Robert M. Hitt III, South Carolina Secretary of Commerce, *Allowable Ex Parte Communication Briefing Regarding Commerce Overview, Current Economic Development Activity, and Role Energy Plays in Recruiting and Growing Business* (Sept. 19, 2019).

7. Criminal and Civil Penalties, Fines and Judgments

The next category in the ORS table concerns penalties, fines and judgments. While the Companies generally agree that criminal and civil penalties should not be recoverable in rates, the Companies take exception to the proposed disallowance of settlements and associated legal expenses, and the proposed categorical disallowance of judgments and associated legal expenses. The orders cited by ORS refer consistently to the disallowance of "penalties" or "fines," terms that imply wrongdoing on the part of the utility. Unlike penalties or fines, settlements and judgments do not necessarily lead to an inference that the utility committed wrongdoing or did something in bad faith, and disputed matters are settled frequently for many reasons other than the settling parties' underlying views of the merits of the case. Settlements limit litigation costs, which ultimately inures to the benefit of the utility's customers. As discussed above, if settlements and judgments were categorically non-recoverable, utilities would be unable to make "strategic, reasonable, and prudent" decisions that inure to the benefit of customers.[16] Such reasoning could apply whether the end result is a settlement or a judgment from a court or other judicial or quasi-judicial entity. Ultimately, the prudency of a utility's decision-making must be evaluated on a fact-specific, case-by-case basis, but the CertainTEED costs are a prime example of why non-allowables should not be painted with such a broad brush as to restrict utilities and the Commission from acting in the best interest of customers.

[16] Commission Directive at 2, Docket No. 2018-318-E (June 19, 2019) ("The Company's decision to defend itself and to enter into the settlement was a strategic, reasonable, and prudent decision, and a decision that had a net benefit to ratepayers of $50 million. Therefore, the CertainTEED litigation cost adjustment of $830,000 should be recoverable.").

8. Merger and Acquisition

Merger and Acquisition costs are the next category in the ORS Table in Exhibit B. The Companies believe that a categorical disallowance for mergers and acquisitions could impair utilities' and the Commission's ability to make decisions that are ultimately in customers' best interests. The Companies believe that when a utility's mergers and acquisitions activities benefit customers, the costs associated with such activities should be recoverable. Because mergers and acquisitions occur infrequently, and each transaction is unique, the Commission must retain discretion to evaluate cost recovery based on the facts and circumstances of each case.[17] The Companies in particular have a history of transactions which have provided considerable benefit for customers. The expenses to achieve such benefit, if reasonable, should be allowed for recovery and not categorically denied. Indeed, such categoric denial would contravene the guidance set out by the S.C. Supreme Court. Where acquisition or merger costs cause an increase to rate base, but the acquisition itself would inure to the benefit of customers—whether through avoided costs or downward rate pressure overt time or other such benefits—the Commission should consider permitting recovery of such costs. When cost recovery is categorically disallowed, opportunities to benefit customers are arbitrarily eliminated.

9. Inflation, Expense Estimates, and Contingencies

The final category in the ORS Table concerns inflation, expense estimates and contingencies. The Companies strongly disagree that inflation, expense estimates, and

[17] *See* Order No. 2018-369 at 13, Docket No. 2017-28-S (June 1, 2018) ("The Synergy merger expenses have benefited and will continue to benefit both the ratepayers and Company. The Commission recognizes that public utilities incur legal costs, both for corporate governance and for regulatory compliance. Public policy should encourage public utilities to comply with both corporate and regulatory law. The merger costs are justified, and will be allowed to be amortized over three years.).

contingencies should be categorically excluded. As an initial matter, the items that this category of "non-allowable expenses" contains are not necessarily expenses at all, but are ratemaking inputs, and are therefore not appropriately considered as part of this proceeding. Further, as DESC notes in its most recent comments, this proposal would fundamentally disrupt established principles of utility regulation and accounting. Such items are typically included in a utility's pro forma adjustments within a rate case proceeding and should be evaluated on a case-by-case basis. For example, if the use of historic inflation, as in the case to normalize storm costs from ten years ago to today's cost, results in a lower cost to customers than using only test year or alternative calculations, the Commission should consider and render a decision based on those facts. Additionally, as DESC points out, nuclear outage accruals and major maintenance accruals—which ensure that rates appropriately reflect the costs associated with maintenance activities—necessarily involve estimating future maintenance costs and reflect the impact of inflation.

The purpose of using a test year in a cost-of-service ratemaking context is to match the utility's cost recovery to its expenses on a near-term basis.[18] When presented with an unusual situation resulting in atypical test year figures, the Commission must adjust the test year data. The Commission must make adjustments for known and measurable changes in expenses, revenues, and investments so that the resulting rates reflect the actual rate base, net operating income, and cost of capital. *See Southern Bell*, 270 S.C. at 602-03, 244 S.E.2d at 284-85. Such adjustments are within the discretion of the Commission, and although they must be known and measurable

[18] *See* Order No. 2018-445 at 22, Docket No. 2016-384-S (2018) (citing *Porter v. S.C. Pub. Serv. Comm'n*, 328 S.C. 222, 493 S.E.2d 92 (1997) ("The test year is established to provide a basis for making the most accurate forecast of the utility's rate base, revenues, and expenses in the near future when the prescribed rates are in effect. The historical test year may be used as long as adjustments are made for any known and measurable out-of-period changes in expenses, revenues, and investments.").

within a degree of reasonable certainty, absolute precision is not required. *See Hamm*, 309 S.C. at 291, 422 S.E.2d at 115 (citing *Michaelson v. New England Tel. & Tel. Co.*, 121 R.I. 722, 404 A.2d 799 (1979)); *Porter*, 328 S.C. at 230, 493 S.E.2d at 97 (1997). The test of whether known and reasonable adjustments should be applied is not simply whether a forecast or estimate is used, but whether that forecast or estimate has a reasonable certainty of being accurate. Such items necessarily must be allowed to be litigated in a rate case and not summarily disallowed.

The purpose of the instant proceeding is to clarify the Commission's expectations as related to non-allowable expenses, not to determine what pro forma adjustments that may be included in a rate case application are appropriate. Categorical exclusion of expenses that contain estimates, inflation, or contingencies would be inappropriate and contrary to established case law and Commission precedent.

V. Conclusion

The Companies submit that the goal of providing clarity concerning the treatment of non-allowable expenses is best achieved through the issuance of general policy guidance to aid in efficient rate case hearings where these issues arise, not through promulgation of a binding regulation that categorically disallows certain costs which require fact finding and evidence before disallowance could be ordered. The Companies believe guidelines, if appropriately fashioned, can be consistent with S.C. Supreme Court precedent, which requires the Commission to base its non-allowable determinations on a close examination of the record and to explain its decisions with references to the specific facts relied upon. The Companies appreciate this opportunity to provide input into the Commission's decision-making as related to the appropriate treatment of non-allowable expenses in rate cases.

Respectfully submitted,

Dated this 31st day of August, 2020.

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